

Message Text

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ACTION EUR-25

INFO OCT-01 ISO-00 AID-20 CEA-02 CIAE-00 COME-00 EB-11

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INFO AMEMBASSY ANKARA 3448

AMEMBASSY ATHENS

AMEMBASSY BERN

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E.O. 11652: N/A

TAGS: ECON, OECD

SUBJECT: SHORT-TERM FORECASTERS MEETING JANUARY 10-11

REF: OECD 32469 AND STATE 2167

1. SUMMARY. WORKING GROUP ON SHORT-TERM ECONOMIC PROSPECTS MET JANUARY 10-11 TO UPDATE 1974 FORECASTS TO INCLUDE EFFECTS OF OIL CRISIS. MOST COUNTRIES EXPECTED THEY COULD ABSORB UP TO 10 PERCENT SHORTFALL IN OIL SUPPLIES BY MEANS OF CONVERSION AND CONSERVATION MEASURES. MAIN CONCERN WAS POSSIBLE DEFLATIONARY IMPACT OF OIL PRICE RISES ON DOMESTIC DEMAND, COMBINED WITH CYCLICAL DOWNTURN IN MAJOR ECONOMIES. SOME COUNTRIES SAW POSSIBLE SALVATION IN CONTINUED STRONG INVESTMENT DEMAND DURING 1974, WITH POST-OIL CRISIS RECOVERY IN SECOND HALF. OTHERS WERE MORE DUBIOUS AND EXPECTED SUBSTANTIAL RECESSION LATER IN 1974. OIL PRICE RISES EXPECTED PUSH CONSUMER PRICE INDEX TO TWO-FIGURE LEVEL FOR MOST OECD ECONOMIES. FORECASTS FOR WORLD TRADE DIFFERED RADICALLY, WITH ONE GROUP FORECASTING 6-7 PERCENT GROWTH IN 1974 AND ANOTHER GROUP EXPECTING 0-3 PERCENT. MANY COUNTRIES STILL HAVE NOT ADJUSTED THEIR FORECASTS TO REFLECT CHRISTMAS SUPPLY AND PRICE ADJUSTMENTS, THUS CONCLUSIONS OF MEETING REMAIN TENTATIVE AND PRELIMINARY. INDIVIDUAL COUNTRY FORECASTS REPORTED SEPT. END SUMMARY.

2. IMPACT OF OIL SUPPLY CUTBACKS ON OUTPUT. MOST COUNTRIES REMAINED CAUTIOUS IN ESTIMATING EXTENT OF SUPPLY CUTBACKS FOR 1974, BUT EXPRESSED GROWING CONFIDENCE THAT CONSERVATION MEASURES AND CONVERSION TO ALTERNATE SOURCES OF ENERGY WOULD PERMIT THEM TO ABSORB SUPPLY SHORTFALLS UP TO ABOUT 10 PERCENT OF EXPECTED NEEDS FOR 1974 WITHOUT ADVERSE EFFECTS ON PRODUCTION. U.S. SET TONE BY ANNOUNCING CONSERVATION MEASURES (ALONG WITH FAVORABLE WEATHER) HAD SUCCEEDED IN REDUCING CONSUMPTION MORE THAN IMPORT SHORTFALL, WITH CONSEQUENT INCREASES IN STOCKS OF MOST FUEL TYPES (EXCEPT GASOLINE). MOST COUNTRIES EXPECTED TO MAINTAIN CONSERVATION MEASURES WHILE SUPPLY OUTLOOK REMAINS UNCERTAIN, AND TO HASTEN CONVERSION PROCESS TO ALTERNATIVE ENERGY SOURCES WHEREVER POSSIBLE.

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3. IMPACT OIL PRICES ON DOMESTIC PRICE LEVELS. ALMOST ALL COUNTRIES, WITH EXCEPTION OF JAPAN, WERE MORE CONCERNED WITH IMPACT OF OIL

PRICE RISES THAN WITH SUPPLY SHORTFALLS. MAIN CONCERN WAS THAT PRICE RISES WOULD ADD BETWEEN ONE AND FIVE PERCENTAGE POINTS TO ALREADY HIGH EXPECTED CONSUMER PRICE LEVELS, RESULTING IN 9-14 PERCENT ANNUAL RATE INFLATION FOR EUROPEAN COUNTRIES AND

JANPAN. THIS INCREASE IN INFLATION RATE MAY HAVE DEFLATIONARY IMPACT ON CONSUMER DEMAND, WITH POTENTIAL ADVERSE CONSEQUENCES FOR PRODUCTION, EMPLOYMENT AND NEW INVESTMENT IN SECOND HALF 1974.

IMPACT OF OIL PRICE RISES ON CONSUMER PRICE INDEX IN 1974

COUNTRY INCREMENT IN CPI FORECAST
DUE TO OIL IMPACT RATE OF INFLATION

CANADA	N.A.	OVER 8-1/4 (1ST HALF)
FRANCE	N.A.	ABOUT 12 (1ST HALF)
GERMANY	2-2-1/2	8-1/2 OR MORE
ITALY	4-4-1/2	13 OR MORE
JAPAN	3-4	14
U.K.	OVER 1	N.A.
U.S.	N.A.	UNDER 8-1/2 (1ST HALF)
AUSTRIA	OVER 1	8-1/2
BELGIUM	N.A.	10-11
IRELAND	2-1/2	11
NETHERLANDS	5-6	14
NORWAY	2	N.A.
SWEDEN	N.A.	10-1/2

4. PRICE IMPACT ON OUTPUT. THERE WS STRONG DISAGREEMENT REGARDING PROSPECTS FOR 1974 BETWEEN THOSE COUNTRIES (U.S., JAPAN, GERMANY AND AUSTRIA) WHICH FORECAST STAGNATION OR MODERATE DOWNTURN IN FIRST HALF FOLLOWED BY RECOVERY TO NEAR POTENTIAL GROWTH RATE IN SECOND HALF, AND SECRETARIAT PLUS OTHER COUNTRIES (U.K., NETHERLANDS, BELGIUM, FINLAND) WHICH EXPECTED DISMAL FIRST HALF FOLLOWED BY EVEN STEEPER DOWNTURN IN SECOND HALF. BULLISH FORECASTERS JUSTIFIED THEIR OUTLOOK ON BASIS THAT (A) OIL SUPPLIES WILL HAVE RETURNED TO NEAR NORMAL LEVELS, (B) PRICE RISES WILL NOT BE REPEATD AND INVESTORS CAN PLAN WITH GREATER CERTAINTY, (C) REDUCED CONSUMER LIMITED OFFICIAL USE

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DEMAND FOR HIGH OIL CONTENT GOODS (E.G. AUTOS, AIRPLANE TRAVEL, PETROCHEMICALS) WILL BE OFFSET BY INVESTMENT IN ALTERNATIVE ENERGY SOURCES, (D) CONTINUED STROG INVESTMENT DEMAND WILL BE COMBINED WITH GREATER AVAILABILITY OF FUNDS IN INTERNATIONAL CAPITAL MARKETS AS ARAB OIL PROCEEDS RETURN TO EUROPE AND AMERICA, (E) RESTRICTIVE POLICIES WILL BE RELAXED IN SECOND HALF OR STIMULATIVE POLICIES WILL BE INTRODUCED, (F) EXPECTED CYCLICAL UPTURN WILL OCCURN AND (G) PROSPECTS FOR WORLD TRADE WILL IMPROVE AS ARAB OIL EARNINGS ARE TRANSLATED INTO INCREASED EXPORT DEMAND. BEARISH FORECASTERS, CHIEFLY U.K. AND SECRETARIAT, CONSIDERED FURTHER DOWNTURN LIKELY BECAUSE (A) DEFLATIONARY EFFECTS OF OIL PRICE RISE ON DEMAND WILL BE EXAERBATED IF COUNTRIES CONTINUE RESTRICTIVE POLICIES AGAINST INFLATION, (B) RECENT DEFLATIONARY POLICIES INTRODUCED SECOND HALF 1973 HAVE NOT YET WORKED THROUGH,

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AMEMBASSY PARIS UNN
AMEMBASSY REYKJAVIK
AMEMBASSY ROME
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(C) INVESTMENT MAY DECLINE DUE TO CONTINUED UNCERTAINTY, BOTTLENECKS AND TIME LAGS BEFORE NORMAL ECONOMIC ACTIVITY RESUMES, (D) BUSINESS PROFITS MAY BE SQUEEZED DUE TO DETERIORATION IN TERMS OF TRADE AND LIKELIHOOD WAGE CATCH-UPS, (E) OUTLOOK FOR WORLD TRADE IS DISMAL BECAUSE OF TRANSFER OF SPENDING POWER FROM SPENDERS TO SAVERS, AND BECAUSE OF TIME LAGS BEFORE ARAB OIL EARNINGS CAN BE TRANSLATED INTO INCREASED EXPORT DEMAND.

5. IMPACT ON EMPLOYMENT. MAIN IMPACT OF OIL CRISIS ON EMPLOYMENT EXPECTED IN OIL-DEPENDENT INDUSTRIES SUCH AS AUTOS AND AIRLINES AND IN SOME EXPORT FIRMS. U.S. EXPECTS 5.5-6 PERCENT UNEMPLOYMENT RATE FOR 1974 WITH PEAK AT MID-YEAR. GERMANY EXPECTS SHORT-TERM INCREASES ABOVE 1.9 PERCENT LEVEL RECORDED IN DECEMBER. FRANCE SEES AN INCREASE IN UNEMPLOYMENT OF ABOUT 100,000 PERSONS. U.K. EXPECTS SOME DECLINE, BUT MAY BE SAME PEOPLE WHO ENTERED LABOR MARKET FOR FIRST TIME IN 1970-71.

6. DEMAND MANAGEMENT POLICIES. SECRETARIAT NOTED THAT MOST COUNTRIES DID NOT APPEAR EAGER TO INTRODUCE CONTRA-CYCLICAL POLICIES TO OFFSET DEFLATIONARY EFFECTS OF OIL PRICE RISE AT TIME WHEN DOMESTIC PRICES INCREASING SO FAST. SECRETARIAT WAS CONVINCED THAT NEW POLICY MEASURES WOULD BE NEEDED IF SHARPER DOWNTURN, PARTICULARLY LAST HALF 1974, IS TO BE AVOIDED. U.S. DEL REPORTED EXPECTATION OF BUDGET DEFICIT AS RESULT GREATER TRANSFER PAYMENTS. JAPAN WILL CONTINUE TO EMPHASIZE MEASURES TO CONTAIN INFLATION AND WILL INTRODUCE VERY RESTRICTIVE BUDGET FOR FY 75 (BEGINNING APRIL). JAPANESE EXPECT SOME RELAXATION LATER IN 1974, AND MAY CONSIDER INCREASED TRANSFER PAYMENTS TO OFFSET DECLINE IN SAVINGS RATIO. GERMANS SAID THEY HAVE ALREADY DECIDED TO RELAX BUDGETARY RESTRICTIONS BUT ARE NOT YET SHIFTING TO AN EXPANSIONARY POLICY, AS PROPOSED BY SECRETARIAT. THEY MAY INTRODUCE MEASURES TO STIMULATE DEMAND ON SECTORAL BASIS WHERE IMPACT ON PRICES CAN BE MINIMIZED. ITALY SAID THAT AT PRESENT IT IS NOT CONSIDERING MEASURES TO CORRECT DEMAND. FRANCE AND U.K. WERE NOT PARTICULARLY INFORMATIVE ABOUT POSSIBLE CHANGES IN THEIR CURRENT POLICY STANCES.

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7. FOREIGN TRADE AND PAYMENTS. STRONG DIFFERENCE OF OPINION SURFACED REGARDING OUTLOOK FOR OECD TRADE IN WAKE OF MASSIVE TRANSFERS OF INCOME TO OPEC STATES. SECRETARIAT NOTED LARGE

DETERIORATION EXPECTED IN CURRENT BALANCES OF OECD NATIONS, BUT NEVERTHELESS TOOK OPTIMISTIC VIEW THAT VOLUME OECD EXPORTS WOULD INCREASE BY ABOUT 7 PERCENT IN 1974. THIS ESTIMATE BASED ON ASSUMPTION THAT OEC AND NON-OIL LDC'S WILL INCREASE EXPORT DEMAND BY 4 PERCENT AND OPEC NATIONS BY 40 PERCENT. SECRETARIAT ESTIMATES VOLUME IMPORTS LIKELY RISE ONLY BY 3-1/2 PERCENT IN 1974. OECD IMPORT UNIT VALUES ARE EXPECTED RISE BY 25 PERCENT, OF WHICH OIL ACCOUNTS FOR 10 PERCENTAGE POINTS. EXPORT UNIT VALUES ANTICIPATED RISE BY 12 PERCENT, LEADING TO SUBSTANTIAL DETERIORATION IN TERMS OF TRADE. FRANCE, GERMANY, ITALY, AUSTRIA AND SPAIN AGREED WITH 6-7 PERCENT FORECAST FOR VOLUME TRADE. UK, JAPAN, NETHERLANDS AND CANADA SAW CONSIDERABLY LOWER GROWTH IN TRADE, FROM 0-3 PERCENT. SECRETARIAT FORECASTS WERE CHALLENGED ON GROUNDS THAT OPEC EXPORT DEMAND UNLIKELY TO RISE BY 40 PERCENT IN 1974 DUE TIME LAGS IN PLACING ORDERS AND BECAUSE OF LIMITED ABSORPTION CAPACITY OF OPEC COUNTRIES. STRONG DOUBTS WERE ALSO EXPRESSED REGARDING LDC ABILITY TO MAINTAIN EXPORT DEMAND FOR OECD EXPORTS BY MEANS OF INCREASED BORROWING.

8. NON-OIL LDC CURRENT ACCOUNT POSITION IN 1974 EXPECTED DETERIORATE SEVERELY. PRIOR TO OIL PRICE RISES, LDC CURRENT ACCOUNT DEFICIT EXPECTED TO BE \$10 BILLION WHICH COULD HAVE BEEN FINANCED LARGELY BY EXTERNAL BORROWING. OCTOBER PRICE RISES ADDED \$5.5 BILLION TO LDC IMPORT BILL, WHICH STILL COULD HAVE BEEN FINANCED FROM 1973 RESERVE INCREASES RELATED TO COMMODITY PRICE BOOM. DECEMBER OIL PRICE INCREASES WILL ADD FURTHER \$10 BILLION TO IMPORT BILL, FOR WHICH FINANCING WILL BE EXTREMELY DIFFICULT IN FACT OF COMPETITION FROM OECD BORROWERS IN EURO-CURRENCY MARKETS. MOREOVER, ANY ADDITION TO ALREADY HIGH LDC DEBTS WILL POSE GREAT DIFFICULTY IN SERVICING.

9. IMPACT OF WORLD TRADE CONDITIONS ON DOMESTIC POLICIES. ITALIANS WARNED THAT COUNTRIES WITH WEAK RESERVE POSITIONS OR POOR RECENT CURRENT ACCOUNT PERFORMANCE WOULD BE FACED WITH ACUTE PROBLEMS IF EXTERNAL FINANCING NOT AVAILABLE, AND THEY MIGHT HAVE TO TAKE APPROPRIATE MEASURES. BELGIUM NOTED THAT IF COUNTRIES IMPOSED RESTRICTIVE DOMESTIC MEASURES TO PROTECT LIMITED OFFICIAL USE
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THEIR CURRENT ACCOUNTS, THIS WOULD HAVE FURTHER DEPRESSIVE EFFECT ON WORLD ECONOMIES AND WORLD TRADE.

10. ONE SET OF WORKING DOCUMENTS DISTRIBUTED AT MEETING HAVE BEEN AIRPOUCHED STATE, EUR/RPE (KINNELLY).
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